STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 7336

Petition of Central Vermont Public Service
Corporation for Approval of an Alternative
Regulation Plan Pursuant to 30 V.S.A. § 218d

BRIEF AND PROPOSED FINDINGS
OF THE DEPARTMENT OF PUBLIC SERVICE

The Department of Public Service, by its undersigned Special Counsel, submits the following proposed findings of fact and legal argument for consideration by the Public Service Board in this matter. The Department supports approval of the Alternative Regulation Plan proposed by CVPS, provided that it is modified in accordance with the evidence submitted by the DPS and as described further herein.

Proposed Findings

1. The Department of Public Service supports adoption of the Alternative Regulation Plan (ARP) proposed by CVPS, as modified by the Company's testimony filed March 28, 2008, and with the further modifications described in the prefiled testimony of DPS witness Ron Behrns, DPS Director of Finance & Economics. Behrns pf. at 3.
2. Two significant modifications should be made to the ARP. First, the "Unicap" and "Sub cap" proposed by the Company should be replaced by a non-power cost cap. Second, the proposed earnings sharing bands should be modified by elimination of the below-investment-grade bands. *Id.* at 4-5.
3. Other, minor changes should be made as well. Recovery of unanticipated energy-efficiency or distributed-resource costs should be evaluated to determine if they warrant amending the ARP. In addition, earnings sharing adjustments should be made only once per year. *Id.* at 5, 16-17.
4. The Unicap as proposed by CVPS functions as a cap on non-power costs. While it limits the adjustment to rates in any one year, any power costs not recovered

would be deferred for later recovery. As such the Unicap is similar to the non-power cost cap included in the Green Mountain Power Alternative Regulation Plan, except that the Unicap would allow recovery of much higher amounts than allowed for GMP. *Id*. at 9.

5. The Unicap would allow for annual rate increases of over 7% over the term of the ARP. CVPS has not justified the need for increases of that magnitude. Behrns pf. at 9-10. CVPS has not had rate increases of that size in recent history. Tr. 7/9/08 at 64-65 (Deehan).
6. The market price of power has been increasing. Tr. 7/10/08 at 67-68 (Deehan). CVPS has excess power that it sells into the market, and thereby benefits from higher market prices. *Id*. The primary source of potential cost increases for CVPS are from the operational risks of Vermont Yankee. *Id*. at 68. However, CVPS has outage insurance that mitigates its risks from a Vermont Yankee outage. *Id*. at 107 (Deehan).
7. The Unicap as proposed by CVPS has not been shown to be an effective incentive for the Company to control its costs. The Unicap would allow increases of 16% per year in non-power costs. This does not provide an incentive to CVPS to control its costs; rather, it would accomplish the exact opposite of its intended purpose by allowing significant cost increases. Behrns pf. at 10-11. *See also* tr. 7/9/08 at 67 (lines 16-25) – 68 (lines 1-8) (Deehan).
8. The ARP as proposed by CVPS also includes a Sub cap that places a limit on some, but not all, of the costs that the Company considers controllable. Tr. 7/9/08 at 198-200 (Keefe/Cook); Behrns pf. at 12. We find that the Company should have a clear incentive to control <u>all</u> of its costs, including those impacted by the asset management plan. See *id*. at 200.

<u>Argument</u>

The statutory criteria for approval of an alternative-regulation plan include requirements that the plan have "clear incentives to provide least-cost service," provide "just and reasonable rates," and encourage the company to "operate as efficiently as possible." 30 V.S.A. § 218d(a)(1), (a)(2), and (a)(7). A plan that contemplates annual rate increases of 7%, higher than any increase the Company has been able to justify in the past decade at least, does not satisfy those criteria. The Department's primary concern in this docket and others is the ability or willingness of CVPS to control its costs.

The only real justification that CVPS has offered for the lax incentive of the 7% Unicap is the possibility of outages at Vermont Yankee. This risk is mitigated by insurance procured by the Company (at the Department's behest). There are presumably other portfolio management strategies that could ameliorate the risk presented by the Company's reliance on its unit-contingent VY contract. There should be pressure on CVPS to research, develop and deploy such strategies, rather than allowing it to assume that excessive costs will simply be passed on to consumers. In the case of a truly extraordinary event at VY that CVPS could not reasonably mitigate or hedge against, it has the option of seeking extraordinary rate relief.

Given the ARP's provisions allowing deferral of power costs to future years, the only "direct incentive" to the Company to manage efficiently is the desire to avoid delayed cash flow – an incentive that has proven inadequate to discourage large deferrals in the past. Tr. 7/9/08 at 79 (Deehan); *id*. at 238-244 (Keefe/Cook). The Company also points out, however, the PSB still has the power to conduct prudence reviews of its management. Tr. 7/9/08 at 80-81 (Deehan).

Prudence reviews are a clumsy and expensive method to ensure efficient operation by the Company, and reliance on them runs counter to a fundamental rationale for alternative regulation: streamlining the regulatory process, and providing <u>incentives</u> to a utility to operate <u>efficiently</u> in the interests of ratepayers. Mere avoidance of a finding of imprudence is not equivalent to an effective incentive "to operate as efficiently as possible . . . ." 30 V.S.A. § 218d(a)(7).

The Department also finds it difficult to believe that the Company would <u>want</u> oversight of its operational efficiency to be carried out by means of prudence reviews, or even litigation of its rate filings. A plan that relied on these means to encourage cost control would seem to send a message to the investment community exactly opposite to the message CVPS seems to want to convey. It would be more productive to approve a plan that contained relatively stringent limits that required the Company to truly "sharpen its pencils."

The PSB should reject the company's Unicap proposal, and adopt the following findings.

<u>Proposed Findings, continued</u>

9. The Unicap proposed by CVPS should be replaced with a non-power cost cap similar to those in other Vermont alternative regulation plans. The non-power cost cap approved here will be formulaically determined by using a lagging consumer price index, prospectively adjusted for the rate year (1) targeted productivity changes and (2) any unusual rate base changes occasioned by known and measurable and used and useful net plant and other rate base additions. In conjunction with the other revisions we adopt to the ARP, this cap will provide just and reasonable rates for Vermont rate payers over the duration of the plan. CVPS will have a clear unambiguous rate path over the term of the plan that will aid them in securing a corporate investment grade credit rating while meeting service quality and reliability requirements. Behrns pf. at 12-13.
10. The formulaic determination of the cap is likely to facilitate administration of the plan by limiting the need for debate and potential litigation. Behrns pf. at 13. More complex proposals advanced by the Company would be more costly and likely to lead to more contention. Tr. 7/10/08 at 126 (Behrns). This is significant in this case due to the disagreement between the DPS and the Company regarding the Memorandum of Understanding (MOU) that resolved the Company's last rate case (Docket 7321). The ARP contemplates cooperation and agreement between the Department and CVPS; the failure to agree on the meaning of the MOU suggests that we should avoid added complexity that could engender disagreement. *Id.* at 127-128.
11. We adopt non-power cost caps of $6.2 million in 2009 and $8.7 million in 2010. These caps have been calculated using the formulaic approach recommended by the DPS, applied to the 2008 alternative regulation cost of service agreed upon in Docket 7321. Behrns pf. at 13. This formulaic approach has been used to

determine the total dollar amount of non-power cost caps for 2009 and 2010, as described in the finding below.

12. The non-power cost cap dollar amounts were determined using the 2007 annual percentage change in the CPI of 4.05% that was adjusted downward for a targeted 50% productivity improvement resulting in a base level non-power cost cap rate of 2.025%. This results in a non-power CPI cost cap of $2.5 million for 2009 and $2.6 million for 2010. (The 2010 CPI cost cap will be adjusted upon the release of the 2008 CPI information.) This cap has been further adjusted to accommodate the need for unusual rate base additions that total $24.4 million for 2009 and $40.9 million for 2010. These rate base additions give rise to an additional revenue requirement of $3.8 million in 2009 and a $6.1 million increase in 2010. *Id*.
13. CVPS has proposed two sets of dead bands and sharing bands. One set would apply as long as CVPS's credit rating is below investment grade, while the second set would apply if and when CVPS achieves an investment grade rating. Behrns pf. at 14.
14. Under the Company's proposal, while CVPS has a below investment grade corporate credit rating, regulated earnings will be evaluated annually using a 50/50 basis point dead band range where, if there is a variation of 50 basis points above or below the authorized return on equity, there will be no sharing. With the 50/50 dead band, CVPS's earnings will be subject to a relatively narrow range of variability and no downside risk beyond the 50 basis point level. If earnings were to exceed 50 basis points above the authorized ROE, the full excess will be returned to rate payers. Likewise, if Vermont regulated earnings were more than 50 basis points below the authorized return on equity, the rate payers would provide additional revenue and make up the difference thus assuring CVPS of a minimum ROE[1] of 9.71% for 2008. Behrns pf. at 15.
15. The second set of dead/sharing bands proposed by the Company would be applied when and if CVPS receives an investment grade corporate credit rating. The dead

[1] The authorized return on equity has been established at 10.21% for the 2008 rate year. This rate will be updated in October of the year preceding 2009 and 2010 based upon applying 50% of the annual percentage change in 10 year Treasury Bill yields to maturity.

band range would increase to 75 basis points above or below the authorized ROE. In addition, a 50/50 sharing would be applied to the next 50 basis point variation in ROE. Variations beyond 125 basis points above the ROE would be returned to rate payers while variations beyond 125 basis points below the ROE would be paid by rate payers. The second set of dead bands and sharing bands (75/75) is consistent with bands in other alternative rate plans in Vermont, and results in a reasonable sharing of risk between the company and the rate payers. Behrns pf. at 15.

16. The first set of dead/sharing bands (applicable while the Company's credit rating is below investment grade) is too narrow, and in effect shifts financial risk associated with a below investment grade credit rating to rate payers when it appropriately belongs with CVPS management and shareholders. Ratepayers should not be penalized or face higher costs as a result of a below investment grade corporate credit rating. Further, CVPS has not demonstrated that the broader range of bands would be detrimental to the attainment of an investment grade corporate credit rating nor have they demonstrated that a more narrow set of bands will promote a credit rating upgrade. Behrns pf. at 15-16.

<u>Argument</u>

The Company's below-investment grade credit rating is the result of the outcome in Docket Nos. 6946/6988. Tr. 7/9/08 at 204 (Cook). That outcome itself was the result of the PSB applying traditional Vermont ratemaking standards and principles to proposals by CVPS that were inconsistent with those standards and principles. Docket Nos. 6946/6988, Order of 3/29/05 at 6-7 and *passim*; *see also* <u>In re Appeal of CVPS</u>, 180 VT 563 (affirming PSB Order in Dockets 6946/6988). It was thus the Company's litigation strategy in that case that ultimately caused the credit downgrade, which in turn has resulted in various additional costs and challenges facing the Company and impacting ratepayers. *See, e.g.,* tr. 7/9/08 at 68, 116-122 (Deehan). It is unfair to impose additional risk (and potentially cost) on ratepayers in these circumstances, especially when the Company has not shown that its proposal would materially affect its prospects for returning to investment grade.

WHEREFORE, the Department of Public Service respectfully requests that the Public Service Board adopt the foregoing findings and approve an Alternative Regulation Plan for Central Vermont Public Service modified as recommended in the Department's evidence.

Dated at Montpelier, Vermont this 8th day of August, 2008.

VERMONT DEPARTMENT OF PUBLIC SERVICE

By: ______________________________

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